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IFSWF Report on Compliance with the Santiago Principles: Admirable but Flawed Transparency

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On July 7, 2011 the International Forum of Sovereign Wealth Funds (IFSWF) released a report on *IFSWF Members' Experience in the Application of the Santiago Principles*. The report is a self-assessment of the voluntary compliance of 21 member sovereign wealth funds (SWFs) with the Generally Accepted Principles and Practices of SWFs, issued in October 2008. We commend the IFSWF for undertaking the surveys on which the report is based, for the later decision to publish the results, and for the detail included in the report. However, as with many self-assessments, the report has some flaws. The principal flaw is that the characterization of the extent of compliance with the Santiago Principles is exaggerated.

The IFSWF report says that 95 percent (404 of 426 responses) of members' practices are fully or partially consistent with the Santiago Principles. But the number of potential responses is 504–24 principles for 21 funds. The IFSWF report drops nonresponses from both the numerator and the denominator. Including nonresponses as noncompliance would reduce the compliance percentage to 80. Giving only half credit for partial compliance would further reduce the figure to 78 percent.[1] Some of the Santiago Principles may not be applicable for all funds, but it is unreasonable to assume that is the case for all 78 of the missing observations. For example, two funds provided no response regarding their legal framework (principle 1). This looks like noncompliance to us.[2]

The IFSWF report also does not disclose the compliance rates for each of the individual SWFs that participated in the self-assessment. Based on our research, some of the 21 funds have substantially lower rates of compliance than others. Table 1 presents a summary of compliance with the Santiago Principles for each of the 21 SWFs covered by the IFSWF report based on the most recent SWF Scoreboard (Truman 2010 and 2011). The summary is based on results for 16 of the 24 Santiago Principles where there is an intersection between the Principles and the 33 elements in the Truman SWF Scoreboard.[3] The average for the 21 funds on the Scoreboard is 72 percent compliance, and the comparable average from the IFSWF report is 80 percent compliance, which is higher but broadly comparable with the

1. We have followed these conventions in our comparisons.

2. In addition, the IFSWF report generally says "all funds" when it means all funds that reported. The report also says "most funds" when it means a majority of reporting funds. For example, only 11 of the 21 funds reported that they have fully or partially reviewed their implementation of the Santiago Principles (principle 24).

3. Where a Santiago Principle overlaps with more than one of the elements in the SWF Scoreboard, we used a simple average of the Scoreboard elements. See appendix 6A in Truman (2010) for the correspondence that we used. Truman 2010 and 2011 score Chile's Economic and Social Stabilization Fund and its Pension Reserve Fund separately while the IFSWF report treats the two SWFs as one entity. Therefore, we averaged the two scores.

Table 1 Compliance with the Santiago Principles by fund

Country	Fund	SWF Scoreboard
Abu Dhabi (UAE)	Abu Dhabi Investment Authority	78
Australia	Future Fund	93
Azerbaijan	State Oil Fund	72
Bahrain	Mumtalakat Holding Company	28
Botswana	Pula Fund	64
Canada	Alberta Heritage Savings Trust Fund	73
Chile	Economic and Social Stabilization Fund and Pension Reserve Fund	66
China	China Investment Corporation	74
Ireland	National Pensions Reserve Fund	95
Korea	Korea Investment Corporation	79
Kuwait	Kuwait Investment Authority	75
Mexico	Mexico Oil Income Stabilization Fund	40
New Zealand	Superannuation Fund	97
Norway	Government Pension Fund	98
Qatar	Qatar Investment Authority	18
Russia	Reserve Fund and National Wealth Fund	47
Singapore	Government of Singapore Investment Corporation	81
Singapore	Temasek Holdings	84
Timor Leste	Petroleum Fund	73
Trinidad and Tobago	Heritage and Stabilization Fund	81
United States	Alaska Permanent Fund	94
Average:		
SWF Scoreboard		72
IFSWF Report		80

Source: Truman 2010, Truman 2011, IFSWF 2011.

Scoreboard assessment.[4] This comparability of the results of the two assessments gives us confidence that the compliance rates for the individual funds shown in table 1 are broadly consistent with the rates of compliance for the 21 funds that participated in the IFSWF self-assessment.

As shown in table 1, on the basis of the SWF Scoreboard, five SWFs score above 90 and eight score above 80, but two score in the 60s, two in the 40s, and one each in the 20s and 10s. The IFSWF report obscures this variation in compliance. SWFs are not homogenous, as the IFSWF report is at pains to point out, but their heterogeneity cannot explain the extent of dispersion in results for individual funds shown in table 1.

The IFSWF report does provide information on the number of SWFs that have implemented each principle since the adoption of the Santiago Principles in 2008. On average, one SWF has done so for each of the sixteen principles on which table 1 is based. In other words, the average score has been raised by about 6 percentage points since the fall of 2008. This figure is somewhat lower than the average increase for the 33 SWFs included in the SWF Scoreboard over the longer period since the Scoreboard was first released in 2007—15 percentage points (Truman 2011).

These shortcomings in presentation obscure the results presented in the IFSWF report, but the report remains an important and valuable document as long as it is read carefully. For example, it allows one to examine the extent of compliance with each of the Santiago Principles. Such an examination is summarized in table 2.

Table 2 is divided into two parts: the 16 principles where there is an intersection with the 33 elements in the SWF Scoreboard and the eight principles where there is no inter-

4. For the full set of 24 Santiago Principles, the average compliance rate in the IFSWF report is 78 percent.

Table 2 Compliance with the Santiago Principles by principle

Principle	Compliance: IFSWF Report	Compliance: SWF Scoreboard	Compliance: Difference
Legal Framework, Objectives, and Coordination with Macroeconomic Policies			
1. Legal framework	88	87	1
2. Policy purpose	88	98	–10
3. Integrated with macroeconomic policies	55	80	–25
4. Source of funds and use of earnings	86	79	7
Subtotal	79	86	–7
Institutional Framework and Governance Structure			
6. Division of roles	88	88	0
7. Role of government	88	88	0
8. Role of governing body	88	90	–2
9. Decisions made by managers	86	76	10
11. Annual report	88	88	0
12. Audit	83	82	1
13. Internal ethical standards	76	51	25
17. Financial information disclosure	83	76	7
Subtotal	85	80	5
Investment and Risk Management Framework			
18. Investment policies	79	57	22
19. Investment principles	74	24	50
21. Corporate responsibility policy	52	31	21
22. Risk management framework	71	57	14
Subtotal	69	42	27
Total (16 principles)	80	72	8
Non–overlapping Principles			
5. Statistical data	83		
10. Accountability framework	90		
14. Third party procedures	71		
15. Disclosure in host countries	74		
16. Governance framework	86		
20. Avoid conflict of interest	64		
23. Investment reporting standards	76		
24. Self review of Santiago Principles implementation	48		
Subtotal	74		
Total (24 principles)	78		

IFSWF = International Forum of Sovereign Wealth Funds

Source: Truman 2010, Truman 2011, IFSWF 2011.

section. In the first part of the table, we present a comparison of compliance (principle by principle) based on the IFSWF report and based on the SWF Scoreboard. The last column provides the difference between the rates of compliance in the two assessments. The first part of the table is further divided into three subsections corresponding to the grouping of the Santiago Principles in the IFSWF report's three categories: legal framework, objectives, and coordination with macroeconomic policies; institutional framework and governance structure; and investment and risk management framework.

With respect to four principles covering legal frameworks and related matters, the SWF Scoreboard rates the compliance of the 21 SWFs somewhat higher than does the IFSWF report—86 percent versus 79 percent. In particular, the Scoreboard assessment is that the operations of the SWFs are more completely integrated with macroeconomic policies (principle 3) and that the policy purpose of the SWF is more clearly defined (principle 2) than is revealed by the IFSWF self-assessments.

Our assessment is that the IFSWF report is substantive and admirable even though we regard it as deficient in some respects.

On the other hand, with respect to the eight principles regarding institutional frameworks and governance, the IFSWF report on average records a moderately higher level of compliance than does the SWF Scoreboard—85 percent versus 80 percent. The principal discrepancy is with respect to internal ethical standards (principle 13)—25 percentage points. It is likely that the reason for this discrepancy is that the Santiago Principles do not recommend that an SWF's internal ethical standards, if any, be publically disclosed; the recommendation is only that they be made known to the members of the governing bodies, management, and staff. Therefore, citizens of the country with the SWF and citizens in other countries have no way to know if the SWF is in compliance with this principle. This is a weakness in the Santiago Principles. The SWF Scoreboard, in contrast, is based on publicly available information that is regularly released.

With respect to investment decisions being made by fund managers (principle 9), the IFSWF report also records a higher level of compliance (86 percent) than does the SWF Scoreboard (76 percent). This is an area where one would expect some positive bias in any self-assessment.

A much smaller discrepancy is on the public disclosure of relevant financial information (principle 17). The SWF Scoreboard includes four separate elements that are identified with this single principle: investment returns, categories, locations, and use of benchmarks. It is, therefore, not surprising that one finds a discrepancy in the two assessments. Moreover, to its credit, the IFSWF report contains a frank discussion of the variation in practices with respect to the disclosure of investment policies by the different SWFs.

In the category of SWF investment and risk management frameworks, the differences between the two ratings of compliance with each of the four principles are substantially larger and uniformly in the direction of a higher rating of compliance in the IFSWF report than on the SWF Scoreboard—69 percent versus 42 percent on average for the category as a whole. One possible explanation for these differences is that the four principles in this category are inherently more subjective. However, it is noteworthy that the average level of compliance in this category of the IFSWF self-assessment is substantially lower than in the other two categories in both ratings.

The principal reason why there is no correspondence between eight of the Santiago Principles and elements in the SWF Scoreboard is that there is no way to verify compliance with most of those principles other than via a statement by the SWF that it complies. (In a few cases, the relevant principle has little operational content.) On the other hand, the average score on these eight principles is only 74, which is somewhat lower than the average score for the other 16 principles. This suggests little bias in these self-assessments. Moreover, if principle 24 (self-initiated reviews of Santiago Principles implementation), is excluded, the average of the remaining seven principles would be 77, even closer to the average for the other 16 principles. Principle 24 is important and would have been included in the SWF Scoreboard except that at the time that Truman was writing there was only a limited record of SWFs following this principle.[5] The IFSWF report itself notes that only four SWFs had published their self-assessments as of the time that report was completed, though three other funds intend to do so.[6]

Our broad conclusion with respect to the 16 principles where one can compare the results in the IFSWF report and on the SWF Scoreboard is that the ranking of compliance is generally consistent even though not identical. In other words, our assessment is that the IFSWF report is substantive and admirable even though we regard it as deficient in some respects.

Moreover, the IFSWF report makes several useful contributions to understanding SWFs.

First, the report is quite frank about some of the issues that arise with respect to the interpretation of its results, for example regarding the application of the principles on investment policies and on nonfinancial restrictions on SWF investment decisions.

5. Those reviews presumably in the future will be informed by the surveys that were used to prepare the IFSWF report, which no doubt was one of the motivations for the surveys and the report, but the self-initiated reviews might be expected to go into even greater depth and specificity.

6. The four SWFs that have published their self-assessments are those of New Zealand, Australia, Norway and Azerbaijan. The three SWFs that the IFSWF report says plan to publish are those of China, Chile, and Timor-Leste. The Abu Dhabi Investment Authority also has published a reasonably complete report of its compliance with the Santiago Principles, but that fact is not included in the IFSWF report.

Second, the report contains a section on transparency. The authors are careful to argue that the objective of the Santiago Principles is not to increase SWF transparency. Nevertheless, the results of the surveys on which the IFSWF report is based clearly indicate that most of the SWFs value transparency for domestic reasons and for the positive impact on their reputations.

Third, the authors acknowledge, though unfortunately only in a footnote, that the IFSWF has a problem with the SWFs of the three countries (Equatorial Guinea, Iran, and Libya) that are members of the IFSWF but did not participate in the surveys. The report states that the IFSWF "will review its membership and discuss with its inactive members about their membership and endorsement of the Santiago Principles before the next meeting of the IFSWF in Mexico in May 2012." Inactive memberships are a problem for a self-regulatory body such as the IFSWF because such behavior reflects adversely on the other members and on the credibility of the forum as an institution. In addition, we hope the IFSWF will be successful in persuading some of the seven SWFs with total assets of more than $25 billion to participate in the IFSWF and to endorse the Santiago Principles.[7] We also hope that this report leads to refinements in the Santiago Principles, which is one of the report's stated purposes.

On the whole, we agree with the IFSWF report that it "represents a solid, initial step toward a better understanding of the IFSWF and of the Santiago Principles, by our stakeholders and by interested parties in general." Well done, but not perfect.

7. The seven SWFs are those of Algeria, Brunei Darussalam, Hong Kong, Kazakhstan, Malaysia, and two funds in the United Arab Emirates.

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